THE ASSOCIATION of CORPORATE CREDIT UNIONS

March 16, 2009

The Honorable Michael E. Fryzel
Chairman, National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

The Honorable Rodney E. Hood
Vice Chairman, National Credit Union Administration

The Honorable Gigi Hyland
Board Member, National Credit Union Administration

Re: Comments on Advanced Notice of Proposed Rulemaking for Part 704

Sent via Email to: regcomments@ncua.gov

Chairman Fryzel, Vice Chairman Hood, and Board Member Hyland:

On behalf of its member corporate credit unions, the Association of Corporate Credit Unions ("ACCU") appreciates the opportunity to comment on the ANPR for Corporate Credit Unions. The ACCU is the primary trade association for the nation's corporate credit unions ("Corporates").

Given the wide-ranging issues addressed in the ANPR, achieving a consensus on all the issues within the Corporate Network is not realistic. As a result, our comments provide background perspective and a principles-based framework of recommendations for further evaluation and dialogue rather than trying to portray a united consensus on each point. Appropriately, separate comment letters from corporates representing the views of their membership will be shared with the agency.

The impacts resulting from national and global market events need to be considered in planning for the future and this may suggest the need for changes in the corporate system. However, the detailed input being sought through the ANPR process comes at a time of great uncertainty in the financial markets and in the valuation of investment securities owned by corporates. Careful analysis, transparency, and ongoing industry deliberation must occur in order to protect and preserve the public interest in shielding credit unions from loss, improving safety and soundness, and enhancing the not-for-profit cooperative financial business model.

The position of the ACCU remains that the ultimate number and purpose of corporates should be determined by their owner/members, the credit unions they effectively and efficiently serve. Any plan addressing corporates should respect the individuality of each corporate and focus on appropriate regulatory requirements for all.

The Role of Corporates in the Credit Union System

<u>*Payment System*</u>

Background

Corporates have offered payment services and managed the associated risks very well for decades. A primary issue relating to the structure of the corporate system relates to corporates' ability to seamlessly process, fund, and mitigate the risks of $7 trillion in annual payment activity of the nation's credit unions. This process is a subset of the overnight and intra-day funding and liquidity risks that corporates incur by being in the settlement services business.

A corporate settles many classes of transactions each day, including the payments it operates, payments others operate (*e.g.,* Federal Reserve, banks, league service corporations, independent processors), deposits and associated dividends, loans and associated payments. Because settlement and payment activities are tied to corporates' balance sheets, mismatching cash flows represents a potential risk exposure that must be appropriately managed.

The historical core purpose of corporates is to provide a convenient way for credit unions to aggregate and centralize their short-term funds management activities (overnight/short-term deposits or loans). Settlement, credit lines, and funds transfer activities provided by corporates are integrated in these core offerings. It would be difficult and cost prohibitive to separate these functions without severely impacting the value corporates provide to the credit union industry. Payment system services provide corporates with a relatively stable source of income and have historically been managed with little operational risk.

Corporates are the primary financial institution for many credit unions and a major component of the value proposition that corporates provide is balancing the demands of payment systems, liquidity, and investments. To maintain this balance, corporates offer full lines of account services, settlement services, payment and correspondent services, as well as short-term and intermediate-term investment and lending options to credit unions. Eliminating any of these offerings reduces the corporate's value as a cash management provider and will lead to significantly greater costs and eliminate options for credit unions to conduct their business in a cooperative system.

Restructuring an existing corporate credit union in a manner that would achieve legal separation of the existing corporate's payment systems lines of business in order to isolate them from other lines of business may be achievable and there are potential benefits including the immediate protection of the isolated assets and business lines. However, significant analysis needs to occur in order to ensure uninterrupted and smooth functioning of the payments system as well as to understand the cost and service impacts on the credit union system. Creating an operational and legal firewall to isolate payment risk rather than appropriately managing this risk within the current structure could lead to greater costs, risks, and service inefficiencies for credit unions.

A restructuring would involve the chartering of a new corporate credit union to operate the lines of business for which separation and isolation are deemed appropriate. After chartering, the new corporate and the existing corporate would enter into various legal agreements to address the transfer of assets, liabilities, and capital as well as shared services between the two entities, assignment of certain contracts with members and third parties, and other matters. Capital requirements would need to be identified and/or modified to account for the transfer of risk and new service parameters would need to be established.

ACCU recommendations:

1. Maintain existing corporate business line structure and ensure funds are available to cover settlement through examination process.

Corporates' liquidity plans have been effective during many difficult economic cycles. The recent crisis has underscored several best practices that should be employed, including securing multiple borrowing sources and establishing adequate cash reserves to cover unexpected short-term liquidity swings. Ensuring that funds are available to cover settlement in both normal and stressed scenarios can be achieved through existing corporate liquidity management processes and examiner review rather than stipulated in regulation.

Sound regulation and policy does not eliminate risk, but rather establishes policy rules that measure and mitigate risks while providing a framework for competition and long-term success. The ACCU believes that a separation of payment systems from funds management services is not practical or desirable and that the businesses a corporate delivers should be determined by members after the applicable risks have been identified and appropriately mitigated.

The current payment risk structure at corporates is in line with that in place at other types of financial institutions. This business line structure, which at many corporates includes payment systems as a product line, allows for the benefit of synergies and aggregated cost savings as well as a simplified business model for the credit union system

2. Implement a risk-based capital system for corporates.

Understanding material risks in business line operations and allocating an appropriate amount of capital to these operational business lines (*e.g.*, deposits, lending, settlement services, and payment services) is appropriate and necessary. The measurement of operational risk has been debated among financial institution regulators for years without a definitive conclusion. The Basel capital standards ultimately estimated the capital needed for operational risks should be based on a percentage of gross income or an acceptable internal model created by the institution (*i.e*., the capital needed for specific payment services wasn't defined). We believe a risk-based capital system would more directly address the types and degrees of operational and investment risks than business line structure changes.

3. Encourage corporate payment aggregation.

Corporates and their boards should be encouraged to consider more aggregation of payment systems, which may further reduce operating costs for credit unions and provide for more reliable systems and back-ups as payments continue to migrate to electronic means at an exponential pace. This might entail transitioning payment systems over time into a CUSO type organization, maybe even housed at U.S. Central in order to continue to gain efficiencies of scale. This process should not be regulated, but determined by credit unions and their corporates.

<u>Liquidity and Liquidity Management</u>

Background

Corporates have historically managed liquidity risks very well and have provided liquidity solutions for members through many difficult economic cycles. The current unprecedented and catastrophic economic downturn has created a credit and liquidity crisis few, if any, imagined possible and this has tested even the best liquidity plans. Liquidity is and should remain a core function of corporate credit unions.

ACCU recommendations:

1. Enhance cash flow measurement and reporting.

To effectively manage liquidity, corporates have measurement and reporting processes in place today. To the extent corporates' processes are inadequate to properly assess their cash flows and liquidity risks, regulators can require improvement under best practices and other guidance. Applicable methods that exist and/or could be enhanced include:

- Cash flow modeling across prepayment ranges
- Limits on illiquid asset classes
- Minimums on readily available liquid assets and cash
- Requirements for diversified funding sources
- Model cash flow duration based on historical pattern of deposit flows
- Comprehensive contingency funding plans
- Model liquidity plans for typical fluctuations in economic cycles as well as under more stressed scenarios and adjust liquidity requirements/sources accordingly

2. Enable CLF access for Corporates.

The CLF has proven to be an invaluable, yet under-utilized, tool for the NCUA throughout the credit and liquidity crisis. The NCUA should take all necessary action to assure that the CLF can take full advantage of its statutory authorities to provide funding to corporates. For example, given the fact that corporates are agent members of the CLF, the CLF has the authority to provide funding directly to corporates, including: 1) the ability, in certain circumstances, to provide secured amortizing notes payable; 2) the ability to enter into repurchase agreements and conduct repurchase transactions with corporates using investment securities; 3) the ability to make direct deposits, investments, and/or capital infusions in corporates.

3. Do not limit products and services.

The role of the regulator is to provide oversight and enforcement of the regulations, not make management decisions on behalf of the institutions it regulates. Therefore, the ACCU believes it is inappropriate to try to specify by regulation the types of products and services that a corporate should be limited to offering. The banking industry has tried to limit how credit unions can serve their members by claiming that certain services are not appropriate. This does a disservice to consumers and impedes market competition. If corporates are limited in their product and service offerings, credit unions and by extension consumers would feel the effects by not being able to have affordable access to new products, services or technologies. Changes to or elimination of liquidity services as a core service of corporates would potentially threaten the viability of the credit union system during periods of tight liquidity.

<u>Field of Membership (FOM) Issues</u>

Background

While it is true that corporates are referred to as a "network" or "system", they are each democratically controlled, individual financial institutions. Each corporate approaches its business plan, investment philosophy and execution of mission as a discrete institution. Just as with natural person credit unions, corporates are unitary actors within the larger credit union movement.

Granting corporates national FOMs fostered competition and that may have resulted in increased risk-taking as cited in the ANPR, but it also translated into better rates and expanded service offerings for member credit unions. National FOMs also contributed to margin compression, lower return on assets, slower capital accumulation, and may have fragmented innovation and product operations as corporates sought ways to gain advantages over each other.

However, a return to geographic fields of membership would not necessarily improve corporates' financial prospects or reduce risk. For example, the Federal Home Loan Bank model did not protect those banks from market consequences that are quite similar to those that corporates currently face.

ACCU recommendations:

1. Allow credit union choice and require contributed capital to obtain corporate services.

An alternative to limiting corporates' FOMs is to require that each natural person credit union adequately capitalize each corporate that it utilizes for services. Each credit union should be allowed to designate its primary corporate regardless of location and perpetual membership capital (GAAP qualifying Tier 1 capital) should be required for a credit union to obtain services from its primary corporate. Under this approach, standardized capital requirements would be desired so that corporates do not have an inappropriate disincentive to requiring sufficient contributed capital. Corporates should be allowed, however, to vary rates on their perpetual membership capital as currently allowed. This will help build capital and then reward owners for financial performance of the corporate once minimum capital targets are met.

3. Establish process for secondary corporate relationship.

Allow credit unions to diversify their investments and liquidity sources by establishing one or more relationships with "secondary" corporates. Credit unions could be allowed to obtain select services (*e.g.*, term investments, term loans, payment services, etc.) by depositing Membership Capital Shares (MCS) that qualifies as GAAP Tier 2 capital as well as term PIC or perpetual PIC in proportion with the level of services utilized. Pricing of these products should be no better than what a "primary" member could obtain from the corporate.

Enabling corporates to distribute other corporates' investment and lending products for a fee is also an option that could be explored. This would allow credit unions to support the cooperative financial business model and structure while diversifying investments and liquidity sources across multiple corporates. To succeed, corporates must continue to cooperate, leverage resources, enhance margins, and accumulate capital in the interest of the credit union system.

<u>Expanded Investment Authority</u>

Background

The agency currently grants specific expanded authorities and sets limits based upon a corporate's capital, risk profile, and ability to utilize expanded authority tools effectively and safely. Access to expanded authorities requires significant investment in staff, systems, and process development. The bar for expanded investment authorities is already set very high given the many factors involved in granting authorities.

Some corporates use expanded authorities to increase investment options (for both diversification and yield), create product offerings, mitigate risks by using derivatives, and facilitate member liquidity by participating in member loans. The expanded investment authorities have valid applications and financial services providers outside the Corporate Network have these tools available to them. Therefore, the availability of expanded investment authorities should not be at issue, especially in view of the desirability for competitive equality. Rather, the appropriate focus for the NCUA should be on whether or not corporates with expanded authorities have the appropriate expertise, systems, processes, and controls to utilize the tools effectively and safely, as well as whether or not the NCUA has appropriate expertise and processes in place to assess and monitor the associated risks.

ACCU recommendations:

1. Expanded investment authorities for corporates are appropriate and broader authorities should be considered.

The need for expanded authorities in order to generate value for the credit union system continues. In fact, credit unions might be better served by an expansion and broadening of the expanded authority regime, which currently forces a concentration risk at all levels of the credit union system. For example, credit unions are exposed to direct investment risks by their holdings of mortgages, auto loans, and credit card receivables. As a result of the current restrictions on corporate investment authorities, corporates are indirectly exposed to essentially the same investment risks through their holdings of securities backed by mortgage, auto loan and credit card receivables collateral. Therefore, rather than curtailing expanded investment authorities, the NCUA should consider revising and extending the scope of its corporate credit union expanded authorities regime to facilitate more effective and efficient risk mitigation across the system.

2. Align risks with higher capital levels and other parameters to ensure controls are appropriate.

Given the dynamics of market events, a review of parameters governing expanded investment authorities is appropriate. This review should encompass not only corporate systems, expertise, capital levels, and process controls to effectively and safely exercise these authorities, but this review must also evaluate whether NCUA has the appropriate expertise and control processes to monitor, measure, evaluate, and control these activities.

Structure: Two-Tiered System

Background

The basic premise of the two-tier corporate structure (U.S. Central and individual corporates) is aggregation and centralization of resources and expertise to take advantage of economies of scale, which is particularly important given the narrow margins in the "wholesale" investment markets where corporates typically operate. Centralized functions and aggregated balances in the corporate system will continue to yield advantages for credit unions.

The two-tiered corporate system has historically functioned very well with many aggregated products, services, and benefits accruing to credit unions through collaborative corporate efforts. However, capital accumulation at both tiers has always been challenging given the historically low margins and ROAs on which the Corporate Network has operated, consistent with its mission of providing superior returns to credit unions. Capital accumulation at both tiers is even more challenging today and will be in the future in light of prospective losses and anticipated increases in capital requirements across the entire financial services industry.

The multiple retail corporate business model within the Corporate Network remains viable and necessary. While arguments can be made that fewer corporates (or a single corporate) may create operating efficiencies, the concentration of risk, lack of diversification, and other issues may counter operating efficiency gains. Real or perceived inefficiencies of the multi-corporate model can be tempered if the level of cooperation across the Corporate Network is increased. As noted in the FOM section, corporates must continue to cooperate and leverage resources to meet member needs, enhance margins, and accumulate capital. Solutions for enabling credit union diversification of investments and borrowing across multiple corporates are also important.

There are areas where corporates should look to cooperate further and this might entail centralizing functions for scale. This could include payment operations, shared back office services, risk modeling, member call centers, technology services, business lending, and brokerage services as examples. Function optimization across the corporate system should be carefully evaluated to determine benefits and risks. This optimization could require several years and considerable expense to complete, but the long-term strategic and financial benefits to the industry could be significant.

ACCU recommendations:

1. *Transition U.S. Central's role.*

There is a need for a continuing wholesale corporate, U.S. Central, although that role could change to more strategically serve corporate and natural person credit union interests in the future. A concern with the current structure is that U.S. Central assumes a disproportionately large share of the credit risk under the existing structure but it has the least amount of capital. Aligning sufficient capital where the risk exposure exists is necessary.

An alternative would be to move towards a structure that keeps certain resources and expertise centralized, but investment purchases occur on the individual corporate's balance sheet instead of U.S. Centrals. To gain efficiencies, improve margins, and accelerate accumulation of capital, U.S. Central's role over a period of years could transition away from on-balance sheet term investment management to focus more on investment credit analysis and operate in an investment advisory capacity as well as other off balance sheet activities and aggregator payment-related functions. This would realign risk and capital back to individual corporates. Transitioning U.S. Central's role to off balance sheet asset management and back office functions such as settlement, risk assessment, and external funding could provide for greater stability and more efficient utilization of capital. Identifying the most effective way to perform these central functions for the Corporate Network is critical for continued innovation and effective risk management.

Corporate Capital

Background

Capital levels at corporate credit unions have arguably been adequate to weather historical economic cycles. However, the current market crisis will undoubtedly redefine capital adequacy for corporate credit unions, as it will for all sectors of the financial services industry. Higher capital levels would provide corporates greater ability to either sell securities at a loss when liquidity is needed, or to hold securities that cannot be sold for a fair value and therefore accommodate Other Than Temporary Impairments (OTTI). Higher capital levels would also enable corporates to retain higher credit ratings which will help ensure the preservation of both member balances and external sources of liquidity.

ACCU recommendations:

1. Require contributed capital to obtain services.

Natural person credit unions should be required to maintain a contributed capital account with a corporate in order to obtain services. The calculation should be a function of balances held at the corporate for depository services and a base level that accounts for the risk and other costs of non-depository services. If a credit union were to give notice, a reasonable period of time for capital payback and cancellation of services with the corporate should be given.

As noted in the FOM section, access to corporates' services should be limited to those members that have contributed membership capital shares (MCS), term PIC, and/or perpetual PIC commensurate with their level of service in their primary and secondary corporates.

2. Establish risk-based capital requirements.

Risk-based capital standards should be implemented in a manner consistent with other federally regulated financial institutions. Caution is required, however, because organizations under Basel standards have many more investment authorities than corporate credit unions. Holding corporates to the same capital levels, without permitting them to have the same level of authorities, could lead to underperformance and disintermediation. A thorough review of investment authorities in line with Basel standards is necessary. If the NCUA restricts investment or other authorities of corporates through regulatory changes, then capital requirements should be less than that required of other institutions under Basel standards. Considering the recent turmoil in the financial markets, it is anticipated that the existing Basel standards will change and this will require a further review if and when the Basel standards change.

3. Increase corporate core capital (Tier 1 capital).

All Corporates should attain a minimum Tier 1 core capital ratio of 4 percent based on 12 month daily average net assets (DANA) by the end of 2010 and achieve higher minimum core capital levels in the future, consistent with Basel standards. Flexibility to accommodate the stressed balance sheet conditions of corporates is necessary to build up to this capital level. A 4 percent core capital target is achievable across the network if corporates deleverage their balance sheets (including, in certain cases, decreasing member term deposits) and obtain perpetual member-contributed capital.

A corporate's retained and undivided earnings, together with its perpetual paid-in capital (PIC) shares should constitute core (Tier 1) capital. The NCUA should consider and provide guidance on the question of under what conditions, if any, non-perpetual PIC would be included in the calculation of a corporate's core capital.

Capital divided by 12-month DANA is the appropriate calculation as stipulated in the current regulation. Using 12-month DANA as the denominator appropriately accommodates fluctuations in assets due to cash flow seasonality of credit unions.

4. Retain existing MCS but transition this to Tier 2 capital standards.

Existing membership capital shares are needed given corporates' current capital levels. Allowing MCS to adjust with credit union balance sheets is necessary for the system and in times of tight liquidity, allows credit unions to have flexibility. The agency should allow corporates the option of maintaining this capital structure to augment core capital in order to fund additional products and services.

To provide comparability with other financial institution regulatory frameworks, the NCUA should modify the requirements for MCS so that such instruments would meet applicable Tier 2 capital definitional requirements that are imposed by other federal financial institution regulatory authorities. As total capital levels increase above capital requirements, corporates should be able to retire MCS and term PIC structures as determined individually by each corporate, leaving RUDE and perpetual PIC as the capital foundation. Assuming a corporate meets its minimum capital requirements, delayed payout of capital is not warranted. Withdrawals should be restricted if a corporate would fall below its capital requirement.

5. Align MCS with service usage.

MCS deposits have historically been indexed to assets with a cap on MCS over a specified asset size. A better approach may be to index MCS to the products that benefit from the capital deposits, which could vary across corporates. Adjustments should be allowed between one and four times per year in a manner that is reflective of the cyclical nature of the underlying products that MCS supports.

As noted in the FOM section, provisions are needed to allow credit unions to support the cooperative system while being able to diversify investments, borrowing, and other services across multiple corporates. Two structures could accomplish this:

- Allowing corporates to distribute other corporates' term certificates and term lending as brokered transactions. Limits could govern how much a corporate could distribute through other corporates in order to limit dilution of that corporate's capital. Corporates should not be able to set rates for certificates and loans distributed by other corporates higher than what the issuing corporate's own members can obtain.
- Allowing credit unions to directly diversify their investments and liquidity sources among corporates by establishing one or more relationships with "secondary" corporates. Credit unions should be allowed to obtain select services (term investments, term loans, etc.) by depositing MCS in proportion to the level of services utilized. Pricing of these products should be no better than what a "primary" member could obtain.

Permissible Investments

Background

Corporate balance sheets require a wider range of investment alternatives along with more extensive investment and risk management infrastructure and expertise. Going forward, capital within the corporate system needs to be increased and appropriately aligned with liquidity, structure, obligor/counter-party, and other investment risks. The cooperative concept of aggregating investment authorities and risk still holds merit and that can be improved upon by aligning capital and risk at the same level. Implementing risk-based capital standards will match appropriate investment risk levels to corporates' capital levels and therefore act as a self-regulating force in the process.

If Basel standards will apply to corporate credit unions, it will be necessary to align investment authority levels with other financial institutions under Basel standards for competitive parity. As reviewed in the Expanded Investment Authorities section, corporate credit union investment powers generate value for the credit union system and, while the permissibility of some investment types should be evaluated, consideration also needs to be given to expanding corporate investment options in order to diversity risks across the credit union system, which are heavily concentrated in mortgage based assets, auto, and credit card receivables.

ACCU recommendations:

1. Review permissibility of certain investment types.

The permissibility of some of the investment types noted in the ANPR should be reviewed for appropriateness, specifically Net Interest Margin securities, some CDO structures, and other investment types where the volatility of credit risk is leveraged through structures (*e.g.* when a 10% change in volatility results in a 100% change in the underlying risk). Examples of investment types that should be either prohibited or conditioned include long-term interest-only strips, long-term principal-only strips, and some types of leveraged floaters and inverse floaters.

2. Develop process to review new investment types.

Historically, there has been rapid development of investment types. This may change given new market realities and ongoing market dynamics, but there should be some process in place to effectively evaluate new investment types in a timely manner before they are brought onto corporate balance sheets. Ideally, this review should be performed or validated by a qualified third party and/or NCUA staff. This is particularly important if diversification/sector standards are initiated as new asset classes may be seen as a way to meet such diversification/sector requirements. Any new investment product should not be allowable unless there is some history behind the instrument, a clear understanding of how it works, and the risks associated with the instrument. Corporates would need to demonstrate that they have the expertise, monitoring and control processes, etc. necessary to handle the new investment class. Further, the NCUA needs to have a clear understanding of the product in order to be able to monitor and measure the risk.

3. Care should be taken in reviewing permissible investments.

Corporates should be permitted to invest in current areas and those that counter credit union system concentration areas. Corporate credit unions are already more restricted than banking counter parts and if we move to the same or similar risk-based capital standards, further competitive disadvantages may occur if investment authorities are restricted.

Aggregation of investment expertise at the corporate level benefits credit unions by reducing their cost while improving their safety and soundness and providing cooperative-based returns. The investment powers of corporates should be based on proper infrastructure and capital to support the amount of risk. The regulation and examiner guidance should clearly define what is permissible, how it is to be monitored, and identify all the risk components inherent in investment options.

Credit Risk Management

Background

While published ratings by nationally-recognized statistical rating organizations are a predominant metric for evaluating credit risk associated with investment securities, such ratings are not the only metric that corporates use. Additional inputs include rating agency comments, analyses from other providers (brokers, analysts, and industry sources), internal modeling, historical performance of asset types, and forward looking reviews by industry experts. While generally reliable by historic standards, these metrics have proven to be inadequate throughout the current credit crisis, providing a false sense of confidence as ratings volatility and downward migrations have reached historic levels.

Congress, financial industry regulators, and the financial services industry as a whole must require significant improvement in rating agencies performance. Further, the rating agencies must maintain their independence and minimize conflicts of interest between agencies and issuers.

ACCU recommendations:

1. *Require ratings from multiple agencies.*

Using multiple ratings can be beneficial as no individual model is perfectly predictive of the future. Obtaining ratings from multiple agencies while utilizing or assigning greater weight to the lowest rating can be helpful and provide broader views. However, obtaining multiple ratings can also provide a false sense of security as current credit market dislocations were not accurately assessed by any of the rating agencies. To be more effective, rating agencies need to revise their modeling, internal governance, and accountability to both investors and regulatory bodies.

2. *Define and control concentration limits and enforce optimum (not maximum) diversification.*

New limits and controls should be put in place. However, there are fundamentals to implementing effective limits and controls that should be defined. While “Obligor” is a well defined term, “Sector” is not. Each investor has its own definition of sectors. Therefore, a standard definition of sectors should be created and applied consistently across all corporates. Governance of this definition must be flexible enough to accommodate the pace of change in the industry (e.g. new asset classes) so as a result, it is not feasible for this to be coded in regulation but should be governed by agency guidance.

Diversification on a portfolio-wide view needs to be the hallmark of new guidance for corporates going forward. Care should be applied to avoid unintended consequences of increasing risk by tapping more risky sectors or accepting an inadequate risk/return ratio by over-diversification.

Adequate risk diversification is the first step in a well managed portfolio. Regulation and examiner guidance should maintain flexibility to adjust diversification limits to meet economic and financial market conditions.

The credit quality of nearly every investment sector has been negatively impacted by the market and economic events that began to unfold in 2007. This makes the setting of concentration or sector parameters problematic. Higher overall capital requirements for corporates as suggested previously will mitigate some of the concentration or sector risks. These risks should be monitored on an individual corporate basis during the examination process.

3. Corporates should test sensitivities to credit spread widening.

Credit spread widening should be included as one of the risk parameters in the review of credit risk and this should be included in the reviews of interest rate and liquidity risk. Many corporates monitor their aggregate risk of credit spread widening to previous historical credit spreads. However, today those credit stresses are 10 to 15 times wider than previous events over the past 70 years. A capital charge for the current event moving forward will likely raise lending rates and market premiums and may reduce available credit in the market place. Therefore, careful consideration of impact must be reviewed prior to establishing the guidelines.

Asset Liability Management

Background

The current crisis will prompt significant change in how the financial services industry views, measures, and manages risk, as well as how the various governmental authorities regulate those activities. This will cause numerous changes to related best practices, tools, and technologies as well as to accepted training, knowledge, and experience. Corporates and the NCUA must be able to understand and accommodate these coming changes.

ACCU recommendations:

1. Reinstate requirement for modeling and stress testing net interest income and require modeling and testing of credit spread increases.

There would be some benefit to net interest income and spread widening modeling and stress testing in order to identify trends or potential concerns and this can be evaluated during the examination process. While increased testing and modeling would be beneficial, this would not have prevented the global meltdown since nearly all securities became illiquid and spreads moved wider simultaneously. Understanding the required capital charge for these events would have necessitated more capital retention in order to meet the credit spread widening event. The agency should also consider requiring corporates to model net income and NEV as part of their monthly risk modeling and monitoring processes.

2. Require external reviews of all key risk processes.

The NCUA should consider requiring corporates to obtain external validation of interest rate risk, credit risk, and liquidity risk processes and results to ensure that corporates' views of these risk categories are appropriate and consistent with current risk methodologies, new developments, and industry best practices.

Corporate Governance

ACCU recommendations:

1. Compensation and term limits of corporate directors should be determined by credit union owners.

The issue of compensating directors is linked to attracting "outside" or "independent" directors. However, compensating corporate directors doesn't solve any current problems and there are many arguments for and against director compensation. Corporate boards or their member credit unions should determine whether to compensate directors and what the compensation structure should be.

There are also many arguments for and against term limits and no single position should be imposed upon corporates. Term limits may be gaining popularity in the credit union system and becoming more the norm than the exception. However, this decision should reside with corporate boards and their member credit unions, not the NCUA. Further, it is inconsistent with cooperative's central tenet of democratic control to deny members the right to decide how they will be represented.

2. Allowing outside directors is an issue that should be determined by the owner credit unions.

If credit unions own all or the majority of a corporate's residual value, then those credit unions are entitled as a matter of equity to a majority of the voting control. Therefore, NCUA should leave the decision and number of outside directors up to each corporate and their member/owners, but the agency should prohibit outside directors from outnumbering directors from credit unions.

Also, it should be noted that the current board structures at banks, broker dealers, and other financial industry participants, which have been modified to comply with the Sarbanes-Oxley Act and emerging standards governing accountability and transparency, did not prevent disruptions or insulate these institutions from the market crisis. Therefore, the addition of outside directors cannot be demonstrated to improve the safety and soundness of a financial institution. Accordingly, the NCUA should not require board members to be independent of their credit union or corporate board. The decision to have outside directors should be left to individual corporates, their boards, and their member/owners.

3. Apply credit union guidance to disclosure of corporate compensation information.

Corporates should be subject to the same guidance as natural person credit unions.

4. Consider natural person credit union representation on U.S. Central's board.

Having natural person credit union representation on U.S. Central's board could provide important perspective. While the business model and lines of business of corporates are different from the consumer oriented loan model that natural person credit unions manage, having experienced and knowledgeable natural person credit union representation greatly benefits individual corporates and this could enhance the effectiveness of U.S. Central's role across the industry as well.

We believe that U.S. Central's board should be comprised primarily of corporate credit union CEOs as those corporate CEOs represent the broad and collective insight of their entire credit union membership, but that consideration should be given to having one or two U.S. Central board seats allocated to natural person credit unions.

Other Issues

1. Retain the Office of Corporate Credit Unions (OCCU) or equivalent function.

Corporate credit unions are unique in their purpose, balance sheet composition, product offerings, risk profile, etc. In the interests of protecting the public interest, the regulation, supervision, examination and oversight of corporates should be tailored to corporates' unique characteristics.

2. Provide greater transparency.

NCUA should improve the mechanisms with which the agency communicates information to and about corporates. Corporates should improve transparency for member credit unions by publishing monthly reports detailing financial, portfolio, and risk positions.

We look forward to further dialogue and collaboration with the NCUA Board and the credit union industry to ensure a viable and strong Corporate Network that serves the needs of its owner/members and we appreciate the opportunity to comment and share our views. If you have questions regarding any of our comments or recommendations, please contact me at (202) 508-6731 or via Email at bmiller@cuna.com.

Sincerely,

Brad L. Miller
Executive Director